

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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JUN 29 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)	
)	
Price Cap Performance Review)	CC Docket No. 94-1
for Local Exchange Carriers)	

REPLY COMMENTS OF
THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY

The Southern New England Telephone Company (SNET) replies to the comments filed on May 9, 1994 in response to the Federal Communications Commission's (Commission's) Notice of Proposed Rulemaking (NPRM)¹

1. INTRODUCTION.

In its May 9th comments, SNET encouraged the Commission to eliminate regulatory obstacles and move beyond the current restrictions of the existing price cap plan. Regulatory policies should focus on greater simplicity, greater flexibility and stronger incentives. Such actions will enhance the ability of the local exchange carriers (LECs) to rapidly deploy a national information infrastructure as well as bringing new services to the market. By facilitating the responsiveness of the LECs to customers' needs

¹ Notice of Proposed Rulemaking, CC Dkt. No. 94-1, released February 16, 1994 (NPRM).

and market demands in the Information Age, customers will be offered greater choice and the potential for stimulating economic growth.

In contrast, other parties urged the Commission to do the opposite: to reduce incentives for efficiency and innovation, and continue regulatory constraints inhibiting the ability of the LECs from effectively competing. The Commission should reject those arguments as not meeting public interest goals. In addition, the Commission should reject comments to wait and adopt those necessary transition steps to facilitate and accommodate regulatory policies to changing technological, competitive and market conditions. Such reactive regulatory policies will not permit the LECs to respond with the needed flexibility to developing competition. Opponents' arguments to impose such excessive regulatory requirements would place the price cap LECs at a substantial competitive disadvantage.

The distinctions between elective and mandatory price cap LECs should be maintained. SNET chose price cap regulation because it provided incentives to become more efficient and promised reduced administrative burdens required under rate of return regulation. Fairness dictates that the choice of price cap regulation be linked to stability in the plan's incentives. Arguments presented by those parties that call for an increase in the plan's productivity factor should be rejected.² An increase in the productivity factor would undercut the very incentives that price cap regulation seeks to create

² Ad Hoc Comments, p. 18; MCI Comments, p. 22; AT&T Comments, p. 23; Office of the Consumers' Counsel, State of Ohio Comments, p. 7; General Services Administration Comments, pp. 8-9.

if the productivity offset is reset periodically to account for random statistical fluctuations.³

II. EVEN HANDED REGULATORY DECISIONS ARE NEEDED TO BRING CUSTOMERS THE BENEFITS OF REAL COMPETITION.

A. LECs Should Be Granted Increased Pricing Flexibility in Individual Geographic Markets.

Some parties make the faulty assumption that unless sufficient competition in all markets is present today, the Commission can afford to wait to make changes in price cap regulation.⁴ This logic should be rejected because the nature of competition in access markets is concentrated, not ubiquitous. Commenters assume, incorrectly, that the relevant market to assess competition is the sum of all regulated markets served by a LEC.⁵ In contrast, some commenters recognize, correctly, that "competition will develop at different places for different services in different geographic markets."⁶ It is precisely these developing conditions that is at the heart of the need for action now by the Commission to put in place steps to further the ability of LECs to respond to competition. Even-handed regulatory decisions are needed to bring customers the benefits of real competition.

³ See "Economic Performance of the LEC Price Cap Plan: Reply Comments," prepared by National Economic Research Associates, Inc. and filed as Attachment 4 to the Reply Comments of USTA, June 29, 1994 (NERA Reply), pp. 7-8.

⁴ See MFS Comments, pp. 46-50; and Teleport Comments, pp. 22-23. See also Sprint Comments, p. 25.

⁵ See Ad Hoc Comments, Att. A at p. 100; Teleport Comments, pp. 22-23; MFS Comments p. 44.

⁶ WilTel Comments, p. 34.

B. Full Access Competition Is Coming In The Near Future.

Commenters are wrong in stating that there is "no possibility of significant local competition in the next few years."⁷ In Connecticut, telecommunications legislation has been enacted which recognizes that new rules and regulations are necessary to reflect the changes in technology and markets.⁸ As of July 1, 1994, Connecticut becomes one of the few states in the country to open all types of telecommunications service to competition, including local exchange service.⁹ The transformation of the telecommunications market in Connecticut will be rapid.¹⁰ Customers will benefit from new service choices with the ability to improve their operations, and cut costs.

To facilitate competition, any local telephone company in Connecticut, including SNET, must unbundle functions of its local network that are not themselves already competitive. Unbundling will occur in phases over time as demand and competitive markets develop.

⁷ See AT&T Comments, p. 19. See also ALTS Comments, p. 3; and MFS Comments, pp. 37-38.

⁸ Public Act 94-83, House Bill No. 5420, "An Act Implementing the Recommendations of the Telecommunications Task Force," signed by Governor Lowell P. Weicker, Jr., May 26, 1994.

⁹ *New York Times*, Section A, p. 1, April 17, 1984, "Connecticut: Testing Ground for Communications Future."

¹⁰ Ibid. An AT&T spokesperson was quoted as saying: "This will give Connecticut a more liberal and enlightened climate than any state in the region and any state we know of. We would expect to take advantage of it to the maximum extent."

Connecticut can become a model for other jurisdictions of the recognition that rapidly changing conditions require new regulatory policy mechanisms. SNET urges the Commission to respond in the similar manner, and to put in place an adaptive mechanism now and then, as competition continues to develop, to allow price cap LECs to respond quickly with the same pricing flexibility as their competitors.¹¹

By refining its price cap goals and adopting a system designed to meet these goals, the Commission will take a significant step toward creating a regulatory environment that provides a framework for fair competition.¹²

III. THE FACTS DO NOT SUPPORT AN INCREASE IN THE PRODUCTIVITY FACTOR.

A. Productivity Should be Analyzed on Long-Term Historical Results.

Modest earnings by SNET under price cap warrant neither an increase in the productivity factor nor a one-time adjustment in rates.¹³ Price cap regulation was designed to reward LECs who undertook the risk of innovation and cost savings with the chance for higher earnings than possible under rate of return regulation. If a LEC assumes that any efficiency

¹¹ The demonstration of effective competition will require information from both the LEC and its competitors. The Commission should incorporate adequate reporting or access to relevant information on competition from all market participants.

¹² Rochester Comments, p. 17.

¹³ SNET filed for a Lower Formula Adjustment under the Commissions' rules as part of its 1992 annual access tariff filing. As reported in subsequent annual access tariff filings, SNET's earnings have not been in the sharing range.

incentives will be recaptured, its inclination to engage in such improvements will be reduced.¹⁴

B. Stability in the Productivity Factor is Imperative to Encourage Efficient Behavior.

Price cap regulation offers LECs the opportunity to benefit from efficient behavior. But if a LEC's earnings performance is judged to be the basis for an increase in the productivity offset, with an attendant adjustment in the level of prices, then the outcome is analogous to what occurs under rate of return regulation.¹⁵ Changing the rules after a LEC has chosen price cap regulation is especially inappropriate because it would reduce, or at worst remove, the incentives inherent in the current price cap plan.

In setting a productivity target, the proper measurement period should be sufficiently long to distinguish expected year-to-year fluctuations, from a long-term target.¹⁶ Otherwise, the Commission's objective in preserving the efficiency incentives of price caps is placed in jeopardy. Moreover, focusing on short-term measures of productivity assumes that such productivity gains can be sustained into the future.¹⁷ Competitive pressures will erode any additional productivity gains that can be achieved. Elective price cap LECs

¹⁴ Ameritech Comments, pp. 12-13.

¹⁵ In effect, the opposition parties propose to turn price cap regulation into rate of return regulation with a three year lag. See NERA Reply, pp. 8, 36-37, and 47-48.

¹⁶ NERA Reply, pp. 7-8.

¹⁷ Lincoln Comments, p. 8.

are especially vulnerable because they lack the mandatory LECs' economies of scale.¹⁸

LEC long run productivity can be measured directly through an analysis of total factor productivity (TFP). Independent estimates of LEC productivity growth confirm that the Commission's current productivity offset is not unreasonable.¹⁹

As an option, elective price cap LECs should be able to select a productivity offset consistent with their achieved productivity. Attachment I presents data on SNET's total factor productivity for the period 1981 through 1992.²⁰ Data was derived using the widely accepted methodology of economist Dr. John Kendrick, former Chief Economist for the US Department of Labor, and former Vice President for Economic Research of the Conference Board. SNET's TFP, measured on a long-term average basis for the period, is 1.7%.²¹ This data corroborates other independent estimates of TFP and supports the conclusion that there is no reason to increase the productivity offset. Indeed, the facts support a decrease in the offset.

¹⁸ Ibid., pp. 9-10.

¹⁹ See "Productivity of the Local Telephone Operating Companies," by L. Christensen, P. Schoech and M. Meitzen, filed as Attachment 6 to the Comments of USTA, May 9, 1994, and an update of the Commission's studies performed in CC Docket No. 87-313, filed as Attachment 1 to the NERA Reply.

²⁰ See "Productivity Monitoring Report," dated March 31, 1994, filed by SNET with the Connecticut Department of Public Utility Control, DPUC Docket No. 92-09-19.

²¹ TFP for SNET measured on a five year average basis is less than 3.0%, and has been falling in recent years as a result of declining demand.

III. CONCLUSION.


Rather than accepting the arguments of those who would place additional regulatory impediments in the development of full and fair competition, the price cap plan should be modified to the extent that it can be made more flexible and responsive as competition and technology continue to change the marketplace.

At a minimum, the productivity offset should not be increased, and the facts demonstrate that a lower productivity offset is warranted. Such a change would destroy the incentives that are the heart of price cap regulation.

For all the foregoing reasons, the Commission should reject arguments of those who oppose adaptive regulatory policies necessary for the transition to a more competitive environment.

Respectfully submitted,

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By 

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June 29, 1994

SNET TOTAL FACTOR PRODUCTIVITY

Summary of Total Factor Productivity, 1981 - 1992

	TEP	5 Year Average
1981	4.5 %	4.8 %
1982	-.2	3.1
1983	-.7	1.9
1984	.6	.9
1985	1.8	.3
1986	4.8	1.3
1987	4.7	2.5
1988	2.7	3.0
1989	1.4	2.8
1990	-.7	1.6
1991	-1.4	.4
1992	.7	.6

SOURCE: SNET Productivity Monitoring Report, submitted to Connecticut Department of Public Utility Control (DPUC) March 31, 1994, DPUC Docket No. 92-09-19.

CERTIFICATE OF SERVICE

I, Melanie Abbott, do certify on June 29, 1994, copies of the foregoing Docket No. 94-1 Reply Comments of SNET were hand-delivered or sent postage paid to the following:


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